No. 20,120

United States Court of Appeals

For the Ninth Circuit

LOUIS HORNER, JOHN L. CONNOLLY, VICTOR ROMERO, JAMES RIEMERS, and HUGH BELL for the benefit of THE PACIFIC COAST DISTRICT OF NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION, an unincorporated association,

Appellants,

vs.

W. A. FERRON, HENRY A. BORELLO, W. H. BUTTRAM, ROBERT H. HORNE, C. W. JENKINS, HARRY LEWIS, R. H. ROBINSON, F. E. WALTON, C. BLACK, H. COLEMAN, S. R. FRANKS, GEORGE B. SALOVICH, FRODE ANDERSEN, FRANCIS H. ROGERS, CHEMICAL BANK NEW YORK TRUST COMPANY, a New York corporation, and FIRST DOE through TENTH DOE, inclusive,

Appellees.

Appeal from an Order Denying Application and Motion to File Complaint, of the United States District Court for the Northern District of California, Southern Division Honorable George B. Harris, Judge

APPELLANTS' OPENING BRIEF

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JURISDICTIONAL STATEMENT

On March 31, 1965, appellants moved the United States District Court for the Northern District of

California, Southern Division, for leave to file a complaint against appellees for breach of fiduciary duties under the Labor Management Reporting and Disclosure Act of 1959, 73 Stat. 519 et seq.; 29 U.S.C. §401, et seq. (hereinafter the "LMRDA"). (C. 141-142; 1 R. 1:6).[1] Jurisdiction of the District Court was based upon 29 U.S.C. §501(b).

On April 15, 1965, a final decision was entered denying appellants leave to file the complaint (C. 145-146). Notice of Appeal was filed on April 26, 1965 (C. 147). Jurisdiction of the United States Court of Appeals for the Ninth Circuit is founded on 28 U.S.C. §1291.

STATEMENT OF THE CASE

A. Summary of the Case.

Section 501(a) of the Labor Management Reporting and Disclosure Act of 1959, 29 U.S.C. §§401-531, imposes fiduciary duties upon the officers of labor organizations; Section 501(b) authorizes civil damage actions for violation of such duties, but provides, *inter alia,* that "No such proceeding shall be brought except upon leave of the court obtained upon verified application and for good cause shown, which application may be made ex parte." The present appeal is from a ruling of the lower court that appellants failed

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[1]The Clerk's Transcript will be designated "C." The Reporter's Transcript for March 31, 1965 will be designated "1 R"; the Reporter's Transcript for April 15, 1965 will be designated "2 R." Page references precede the colon and line references, where specified, follow the colon.

to show "good cause" for bringing these proceedings under Section 501.

The complaint herein was sought to be filed by members of the Pacific Coast District of the National Marine Engineers' Beneficial Association (hereinafter referred to as the "District"), a labor organization, against certain District officers for violation of their fiduciary duties under Section 501 (C. 65-70). Appellants seek recovery for District of funds unlawfully paid into a Retirement and Severance Plan for District officers (hereinafter the "Severance Plan") (C. 67:1-17). This is a companion action to that previously filed in the same court on behalf of Local 97 of the Marine Engineers' Beneficial Association (hereinafter "Local 97") (C. 76:25-78:3). The Local 97 action seeks recovery of Local 97 funds unlawfully paid into the same Severance Plan (on behalf of Local 97 officials) prior to April 1, 1962, when District was formed to assume the functions of Local 97 and other locals in the Pacific Coast territory; the instant action is for recovery of District Funds paid into the Plan since April 1, 1962, on behalf of District officials.

Appellants contend, in brief, that the officials of Local 97 (defendants in the Local 97 action) contributed Local 97 funds into the Severance Plan without authority from the membership of Local 97 to do so, and that since the formation of District, officials of District (defendants and appellees herein) have, likewise without authority, contributed District funds into the same Plan.

The Local 97 action is at issue and pending trial, the District Court having ruled that there was "good cause" for bringing that action (C. 77:4-13). The present action was sought to be filed in order to adjudicate, in a consolidated trial, the similar rights of District, Local 97's successor, with respect to the same Severance Plan. However, in the present action the lower court ruled, for unstated reasons, that "good cause" had not been shown (C. 145-146).

B. Statement of Facts.

The showing of good cause made by appellants at the hearing below[2] was based upon the verified complaint (C. 65-70) and upon the declarations of Louis Horner (C. 76-78; 112-116) and John F. Banker (C. 72-73). Declarations and affidavits filed in the Local 97 action were incorporated by reference into the documents filed in this case (C. 77:11-13). These documents set forth the following facts:

1. The Severance Plan was entered into on behalf of Local 97 without authority.

On July 5, 1956, the membership of Local 97 passed Resolution 327, which provided, *inter alia,* as follows:

> Whereas: A pension program has been established for MEBA members which is being maintained by contributions from the shipping companies perfected through our collective bargaining agreement, and

[2]Although Section 501 expressly provides that a showing of good cause may be made ex parte, appellants gave notice to appellees of the time and place when they would seek an order permitting them to file their complaint (C. 141-142), and appellees appeared and contested the motion (1 R. 3:18-4:13).

Whereas: There should also be established, in all fairness, *a retirement* program for our full time Union Officials, and

Whereas: It would not be consistent with sound Union Policy for our Union Officials to come under the Pension Plan to which shipping companies contribute, and therefore, the *retirement* plan for Union Officials should be *independent and separate.* Now Therefore Be It Resolved:

1. An *independent and separate retirement* plan shall be established for the full time Union Officials.

(Emphasis added) (C. 29).

At the time Resolution 327 was passed, the full time officials of Local 97 "represented to the membership that this resolution would be necessary to relieve an unfairness to them resulting from the fact that a pension program for the rank and file members had recently been established by agreement with the Pacific Maritime Association" (C. 24:7-11).

Nearly three years later, on May 1, 1959, without further notice to the membership of Local 97, officials of Local 97 purported to execute the Retirement and Severance Plan which is the subject of this suit (C. 1-K; 24-25; 64). That plan conferred on union officials substantial severance benefits (Trust Agreement, Section VII, C. 4-6), although Resolution 327 did not authorize severance benefits; moreover, it actually *duplicated* existing rank and file pension rights of the officials (C. 24:25-25:11; 27:26-28:1) although the stated reason for passing Resolution 327 was that

union officials should *not* "come under the Pension Plan to which shipping companies contribute" (C. 29).

As Mr. Horner declared, "No one suggested to the membership at that time [when Resolution 327 was passed], nor did I learn until years later, that a *severance* plan was under consideration by these officials whereby *upon quitting* or retiring a *union official would be entitled to a cash benefit* in lieu of a pension. No one explained at that time, nor did I learn until years later, that the full time union officials, including defendants Ferron, Andersen, Borello and Rogers, would [also] become eligible upon their eventual retirement, for a [second] pension under the P.M.A. plan." (Emphasis added) (C. 24:21-28).

From 1956, when Resolution 327 was passed, until 1961 (the Severance Plan was executed in 1959) the membership of Local 97 was not notified of the nature and scope of the Severance Plan (C. 24:29-26:19). It was only after an investigating committee was established, through the efforts of appellants, that full details of the unauthorized Severance Plan were learned (C. 26:17-19; 63-64). Efforts of the officials to prevent this committee from carrying out its investigation resulted in a fist fight, an unlawful arrest, and a protracted civil suit for malicious prosecution (C. 25:17-32).

On August 6, 1963, appellants filed the Local 97 action, seeking return of the funds contributed by Local 97 into the Severance Plan (C. 76:25-77:3). After the introduction of voluminous documentary

evidence and extensive argument at a contested hearing, the District Court ruled that "good cause" for filing the Local 97 action had been established (C. 77:4-17). That action is now at issue and pending trial.

2. District funds were paid into the Severance Plan without authority.

District was formed on April 1, 1962, to assume the collective bargaining functions of Local 97 and other locals in the Pacific Coast region (C. 77:18-21). The formation of District was authorized by a "referendum vote" of the members of the locals involved (1 R. 29:17-30:9). While the membership was informed that District would assume the obligations of said Locals (1 R. 29:17-30:21), the membership was *not* informed that the officials of District would become participants, at District expense, in the Severance Plan (1 R. 37:13-38:20). At no time did the membership of District authorize its officers to participate in said Plan (C. 77:23-26).

3. Relationship of the Local 97 action to the instant action.

Appellants contended below that the pendency of the Local 97 action in and of itself established "good cause" for the instant suit:

> The purpose of the instant action is to recover for The Pacific Coast District and its members the moneys paid by defendant officials into the retirement and severance plan. . . . the court has already upheld plaintiffs' cause of action as against defendants' motion to dismiss, in the case of *Horner et al. v. Local 97;* and said case seeks to revoke and set aside precisely the same retire-

> ment and severance plan involved herein, upon the same grounds asserted herein, as respects Local 97, the predecessor of The Pacific Coast District. Said ruling of the court establishes good cause for the filing of the instant action.
>
> (C. 77:27-78:3).

Counsel for appellees conceded the relationship of the two actions:

> The Court: To what extent would the companion case, so far as the issues presently joined, be determinative of the issues here?
>
> Mr. Jarvis: If the Court reaches the merits, it would be completely determinative of it, Your Honor.
>
> The Court: Because there is no question about the succession in interest of the Pacific Coast organization?
>
> Mr. Jarvis: Correct.
>
> The Court: As a matter of law.
>
> Mr. Jarvis: Correct.
>
> (1 R. 60:5-15).

4. Evidence adduced by appellees in opposition to the filing of the complaint.

At the hearing below, appellees opposed the filing of a complaint on four grounds: (1) that the Severance Plan had been purportedly "ratified" by District (C. 102:29-104:5), (2) that appellants had not exhausted internal remedies (C. 104:29-110:8), (3) that a prior ruling respecting the joinder of District in the Local 97 action was res judicata (C. 99:18-101:25) and (4) that the complaint did not meet certain technical pleading requirements of Rule 23 of the

Federal Rules governing pleadings in shareholders' derivative actions (C. 110:10-111:6). Said opposition was based on the affidavit of defendant Wesley Ferron, president of the District (C. 79-80) and on Ferron's oral testimony (1 R. 27-50).

(a) Ratification.

As respects ratification, the Ferron affidavit incorporated copies of the minutes of the three meetings of *Branches* of District (San Francisco and Wilmington) reflecting the defeat, at Branch meetings, of motions by appellants that District sue to recover funds paid into the Severance Plan (C. 79-80; C. 103:12-32). Further Branch votes, to concur in the San Francisco and Wilmington votes, were had at Seattle and Portland, presumably on motion of appellees (C. 80; 103:32-104:5). The total votes cast against suit at all of said recent Branch meetings was 167 (C. 103:25-104:5); District is comprised of approximately 3,000 members (C. 115:15-16).

Mr. Horner's affidavit established that *none* of these Branch votes, relied upon as "ratifications," were upon motions to *ratify* the Severance Plan:

> Defendant Wesley A. Ferron at no time stated or suggested to the membership that a *vote not to file suit,* as moved by me, would constitute a *ratification* of the Plan itself. Nothing whatever was said on said occasion which could have led any member present to believe that he was voting to ratify or not to ratify the Plan itself; the membership was led to believe only that the motion was exactly what it purported to be, a motion

to instruct the officers of Pacific Coast District to file suit.

(C. 113:15-21).

Ferron further testified, on the ratification point, that when the locals voted to form District, "a letter of explanation . . . went along to each of the members explaining . . . that the District would assume the obligations for the individual locals." (1 R. 30:18-21). Because of such letter, he claimed, the vote to merge was a vote to ratify the Severance Plan (1 R. 30:22-31:2). On cross-examination, Ferron conceded that there was no specific vote on ratification of the Severance Plan, but only a general vote on the subject of merger (1 R. 38:12-14), and that the letter respecting assumption of obligations did not mention the Severance Plan (1 R. 35-38).

The final purported "ratification" was a vote on January 9, 1964, again at a *Branch* meeting (Ex. B to Ferron Affidavit, C. 80:10-12), to approve the minutes of a December 18, 1963 meeting of the District Executive Committee (comprised of appellees) (Ex. A to Ferron Affidavit, C. 80-7-9). The Executive Committee had voted to add the *newly elected* officials of the District to the Severance Plan (but not the officials, including appellee Ferron, who had been participating since April 1, 1962) and to obligate the District to contribute District funds on their behalf into the Plan (Ex. A to Ferron Affidavit). The San Francisco Branch had, according to the minutes of its meeting, voted generally to approve the actions of the Execu-

tive Committee (Ex. B to Ferron Affidavit). The total number of votes so cast was 64, approximately 2% of the membership of District.

Finally, the Horner affidavit stated that said votes were based upon concealment and false statements by defendant Ferron respecting the validity of the Severance Plan:

> Because our union is comprised of a seagoing membership and there is minimal continuity of attendance at meetings, defendants have been able to dominate and control said meetings. *No defendant has ever made a full and honest disclosure to the membership of the invalid nature of the Severance Plan* or of the basis for plaintiffs' objection to it. On the contrary, *defendants have consistently represented to the membership that the Plan was* properly authorized; said representation has been false; and *it has been that representation which has induced the membership to vote as they have.*
>
> (C. 114:11-19).

(b) Exhaustion of internal union remedies.

The principal contention advanced by appellees below was that appellants had not exhausted internal union remedies before seeking judicial relief under Section 501 (C. 104:28-110:8; 138:15-140:2). Appellants urged primarily that Section 501 does not require such exhaustion (C. 132:14-134:13), and secondly, that the District procedures do not afford a remedy for the breaches of trust involved in this case (C. 134:14-136:4).

Appellees argued below that three "internal remedies" had been available to appellants: (1) A "referendum vote" of the entire membership of District, pursuant to Article VI 5(l) of the District by-laws (C. 138:22-29); (2) a trial procedure "of any person charged with any offense" under Articles VI 7(a) and (b) and Article XIII of the District by-laws (C. 138:30-139:2); and finally, (3), a trial procedure under the National Constitution for "charges against elective officials of a District." (C. 139:11-21).

(i) *Referendum vote.* It was undisputed that no individual member has the power, under the District By-laws, to secure a referendum vote. The By-laws provide that:

> The *District Executive Committee* has the authority whenever *it* may determine that it is in the best interest of the membership, to submit to a referendum vote among the membership, any issue, policy or action.
> (C. 138:23-29).

Appellees contended that an individual member may *request* the District Executive Committee to hold a referendum vote (1 R. 55-13-15); but it was undisputed that appellants "have requested the District, its Executive Committee and Officers to take *such action as might be necessary*" to recover the disputed funds (C. 68:17-19; emphasis added); and no referendum vote has been held by the Executive Committee (1 R. 44:4-14). The Executive Committee is, of course, comprised of appellees themselves (C. 115:8-10).

Appellees introduced no evidence showing or tending to show how or in what manner such a vote would secure the return to District of the funds; the referendum remedy was apparently advanced only as a means for preventing future payments into the Plan. Its effectiveness even for this purpose was questionable, inasmuch as the District By-laws provide that the District Executive Committee (appellees) may override a referendum vote (Article III, Section 1).

(ii) *"Trial by Charges" under District By-laws.* While the District By-laws provide procedures for the "trial" of a member charged with "any offense," (C. 138:30-130:2; 80:28-29, Exhibit H), said By-laws expressly provide (Article XII, Section 1) that the *National Constitution* shall govern "the filing of any charges" and the National Constitution imposes special restrictions, described below, upon the filing of charges against a District *official.* Since appellees are District officials, the National Constitution, not the District By-laws, govern charges against them.

(iii) *"Trial by Charges" under the National Constitution.* Under the National Constitution, an *individual* union member does *not* have a right to bring charges against an elected District officer. Such charges may be brought *only* by a "National full-time elected officer or any three members of the National Executive Committee or by a 10% vote of the members in good standing of said District." (Article VIII, Section 1; C. 129:12-19).

Appellees introduced no evidence showing or tending to show how or in what manner such trial proce-

dure would secure the return to District of the funds at issue; indeed, the National Constitution expressly provides that "A decision rendered . . . against any accused . . . shall not in any way affect . . . his civil liability under the law to the National Association or any District." (Article XIII, Section 11).

SPECIFICATION OF ERRORS

The lower court erred in ruling that good cause had not been shown for bringing this action.

ARGUMENT

A. SUMMARY OF ARGUMENT.

In the lower court, appellees opposed the filing of appellants' complaint on four grounds. Appellants' position on such grounds is as follows:

1. Ratification.

Appellees contended that the District-wide vote to merge the various locals into District, and also several Branch votes touching collaterally upon the Severance Plan constituted implied "ratifications" of that Plan. Appellants' evidence showed, on the contrary, that each of the claimed "ratifications" was presented to the membership as a vote on an issue distinct from ratification; that in fact the membership has never been requested to vote for or against ratification; and that, in any event, appellees have *never* made the full

disclosure to the membership which is prerequisite to an effective "ratification" of a breach of trust.

2. Exhaustion of union remedies.

Appellees contended that exhaustion of union remedies is a strict condition precedent to suit under Section 501. Appellants, on the contrary, urge that Section 501—unlike other provisions of the LMRDA—provides a specific statutory procedure to be followed *in lieu* of exhaustion and that appellants have complied with that procedure; moreover, that if exhaustion were required under Section 501, only "reasonable hearing procedures" need be exhausted (Section 411 (a)(4) of the LMRDA), and no such "reasonable hearing procedures" were available to appellants.

3. "Law of the Case."

Appellees contended, without citation of authority, that a ruling in the Local 97 action, denying leave to amend the complaint in that action to name District as a party, somehow barred the present suit. Appellants urge that the doctrine of "law of the case" is inapplicable because that ruling was not a final judgment. It was, moreover, based upon a procedural defect which appellants cured before bringing the instant action.

4. Rule 23 of the Federal Rules of Civil Procedure.

Finally, appellees contended that the complaint should not be permitted to be filed because it failed to plead certain matters required by Rule 23, dealing with shareholders' derivative actions. Appellants'

position is that this is not a shareholders' derivative action; and that the complaint does in fact satisfy Rule 23. In any event, a technical pleading defect cannot support the final judgment entered against appellants.

B. APPELLANTS FULLY SATISFIED THE "GOOD CAUSE" REQUIREMENT OF SECTION 501(b).

1. The legal standard: "Good cause" under Section 501(b) is established by a prima facie showing of merit.

Section 501(b), authorizing civil actions by union members against officers accused of violating the fiduciary duties imposed by Section 501(a), provides that "No such proceeding shall be brought except upon leave of the court obtained upon verified application and *for good cause shown,* which application may be made ex parte." (Emphasis added.) The meaning of "good cause" is not amplified by the statute.

It is apparent that the "good cause" requirement of Section 501(b)—which must be determined before a complaint may be filed—is met by a simple prima facie showing of merit. In *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E. D. Pa., 1960) 182 F. Supp. 608, at 622, fn. 10; *aff'd* 284 F.2d 162; *cert. den.,* 365 U.S. 833, the court stated:

> Although the Act does not specify what is meant by "good cause" in §501(b), it would appear that such a preliminary requirement is intended as a safeguard to the union against harassing and vexatious litigation brought with-

> out merit or good faith. The fact that permission to file the complaint can be granted after an *ex parte* hearing would seem to support this view.

Thus, a verified complaint alone has been found to establish good cause: "The complaint was verified. If true, its allegations constitute 'good cause'." *Executive Board, Local Union No. 28, I.B.E.W., v. Int'l Bro. of Electrical Workers* (D.Md., 1960) 184 F. Supp. 649, at 653.

Until a complaint is filed there can, of course, be no discovery. Discovery rights are essential to a union member suing union officers under Section 501. Such members are, in the nature of things, on the outside; their access to evidence is far more limited than that of the defendant union officers. It is thus inconceivable that Congress intended that more than a "preliminary showing" of "merit" should be required of a plaintiff in order to file a complaint under Section 501(b); and "merit" in this context means not ultimate success but the presence of triable issues.

As stated during the hearing below:

> [Counsel]: The showing of good cause which must be made in order to file, and I stress, Your Honor, that we are merely seeking to file a complaint and adjudicate the questions raised in it, the showing of good cause is presumably less than is required to succeed in the action on its merits. We don't need to win the suit before we file the complaint.
>
> The Court: That is understandable, counsel.
>
> (1 R. 6:19-7:1).

2. The unauthorized payment or use by a union official of union funds violates Section 501(a).

The substantive duties imposed by Section 501(a) are clear: Section 501(a) "establishes a federal duty on the part of labor union officials to abide by the ordinary rules of fiduciary reponsibility."[3] That section provides:

> The officers, agents, shop stewards, and other representatives of a labor organization occupy positions of trust in relation to such organization and its members as a group. It is, therefore, the duty of each such person, taking into account the special problems and functions of a labor organization, to hold its money and property solely for the benefit of the organization and its members and to manage, invest, and expend the same in accordance with its constitution and bylaws and any resolutions of the governing bodies adopted thereunder, to refrain from dealing with such organization as an adverse party or in behalf of an adverse party in any matter connected with his duties and from holding or acquiring any pecuniary or personal interest which conflicts with the interests of such organization, and to account to the organization for any profit received by him in whatever capacity in connection with transactions conducted by him or under his direction on behalf of the organization . . .

An "unauthorized" payment of union funds, made "without the approval, consent or vote of the local union members" constitutes a violation of Section

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[3] *Highway Truck Drivers and Helpers Local 107 v. Cohen* (E.D. Pa., 1960), *supra* at 610.

501(a). *United Brotherhood of Carpenters & Joiners of America v. Brown* (Cir. 10, 1965) 343 F.2d 872, at 884-5.

3. The evidence adduced below showed an unauthorized use of union funds by union officials for their personal benefit.

In the present case, there was little conflict as to the facts. It was undisputed that District funds were paid by appellees into the Severance Plan (C. 77:21-26; 1 R. 29:2-9), that the Plan was for the exclusive benefit of those same union officials, and that it both conferred upon said officials valuable severance benefits not available to the rank and file (C. 4-6), and also effectively duplicated said officials' retirement benefits, because they were entitled to participate concurrently both in the officials' Severance Plan and in the rank and file retirement plan (C. 24:25-25:11; 27:26-28:1).

That the Plan was initially executed by some of the appellees (then officials of Local 97) without authority or notice to the Union was virtually undisputed. The Plan was executed in 1959, pursuant to a three-year-old resolution (Resolution No. 327) which by its terms authorized only a *Retirement* Plan matching that of the rank and file membership; a resolution which plainly contemplated that separate—not duplicate—benefits would be obtained under the officials' plan (C. 29). The terms of the executed plan were not learned by the rank and file until 1961—two years after its execution—and the plan was then disclosed only reluctantly, as a result of an investigation by an

appointed committee of Local 97 (C. 26:17-19; 63-64). At that time, however, appellee Ferron—then Business Manager of Local 97—represented to the membership that the Plan *had* been authorized and that it was valid (C. 114:11-19). No action was taken by Local 97.

(a) Ratification.

Appellees did not dispute that the Plan was initially unauthorized; however, they contended that it was subsequently ratified by District. While admitting below that no District-wide vote specifically referring to the Plan had ever been taken (C. 113:15-21; 1 R. 35-38), appellees nevertheless argued that the Plan had been "ratified" by various votes of Branches within the District. It was undisputed that none of such votes had by its terms been a vote to ratify the Plan (1 R. 35-38); the ratification, appellees contended, was "implied."

There were four votes which appellees claimed were "implied" ratifications of the Plan, the initial vote to form District, two votes at Branch meetings not to bring suit to recover the funds, and a Branch vote approving minutes of a District Executive Committee meeting. Respecting the Branch votes, appellees failed to indicate below how a Branch vote could constitute a ratification on behalf of the entire District.

Appellees' effort to "imply" ratification from votes on collateral matters is similar to an argument rejected in *Berkwitz v. Humphrey* (N.D. Ohio, 1958) 163 F. Supp. 78, at 93. In *Berkwitz,* the board of di-

rectors approved a retirement profit-sharing plan for key corporate employees. The shareholders had never voted to approve the plan; they did, however, vote to set aside certain shares of stock to implement the plan. The court held that the vote to set aside the stock did not constitute ratification of the plan itself, stating: "Shareholder approval was sought on the proposal to implement the plan . . . but no approval of the plan itself was sought." In short, a vote on a collateral subject will not be construed as a ratification.

Moreover, appellants' evidence showed that, in securing the "implied ratifications," appellees had not only failed to disclose to the District Membership either the terms or the original invalidity of the Plan, they had affirmatively misrepresented that the Plan had been validly authorized at its inception (C. 114:11-19). Appellants' evidence further showed that the membership of District was transient and seagoing, that there was minimal continuity of attendance at Branch meetings, and that appellee Ferron dominated and controlled the meetings at which such votes were taken (C. 114).

Under long-established fiduciary principles, a fiduciary's unauthorized acts cannot be ratified unless the ratifying party has full knowledge of the facts surrounding the unauthorized transaction; and the party claiming ratification has the burden of proving it was made with full knowledge of all material facts.

> "For 'a cestui que trust to "ratify" or confirm a breach of trust, *he must be apprised of all the material facts and as well of their legal effect.* No

> half-hearted disclosure or partial discovery is sufficient in either respect. The trustee's duty of disclosure is not discharged by leaving the cestui to draw doubtful inferences, conclusions and suspicions.'
>
> * * *
>
> *One cannot ratify that which he does not know,* and the burden is upon him who relies upon ratification to show that it was made with full knowledge of all material facts." (Emphasis added).
>
> *Central Ry. Signal Co. v. Longden* (Cir. 7 1952) 194 F.2d 310 at 320.

See also *Gaynor v. Buckley* (Cir. 9, 1963) 318 F.2d 432 at 435 ("the two conditions were not ratified by G-P's shareholders because they never had knowledge of them"); and *Berkwitz v. Humphrey, supra,* at 97 ("There must, of course, be a full and fair disclosure of all relevant facts if the shareholders' ratification is to be effective").

Where, as here, the act in question was one which personally benefited the fiduciary, the highest standards of disclosure are required:

> Where directors seek the approval of the stockholders for a transaction in which the directors stand to profit at the expense of the corporation, *every item* of possible profit to the directors and *all information that would enable the stockholders to form a correct estimate of the benefit* accruing to the directors must be disclosed, if the approval of the stockholders is to be of any protection to the directors. (Emphasis added).
>
> *Winkelman v. General Motors Corporation* (S.D. N.Y., 1942) 44 F. Supp. 960 at 985.

In the lower Court, appellees offered no evidence showing that they had made full disclosure; indeed, they did not even *contend* that disclosure had been made.

C. EXHAUSTION OF INTERNAL UNION REMEDIES.

1. The statutory framework of the LMRDA.

The LMRDA, 29 U.S.C.A. §§401-531, was enacted in 1959 as a "comprehensive revision of the labor law,"[4] based upon a Congressional determination, *inter alia,* "that there have been a number of instances of breach of trust, corruption, disregard of the rights of individual employees, and other failures to observe high standards of responsibility and ethical conduct." 29 U.S.C.A. §401(b).

The several subchapters of the LMRDA create distinct categories of substantive rights and duties, addressed to distinct problems. Thus, the LMRDA contains a "Bill of Rights" for the protection of union members (Subchapter II, 29 U.S.C.A. §§411-414); it imposes financial reporting obligations upon labor unions (Subchapter III, 29 U.S.C.A. §§431-440), restrictions on trusteeships (Subchapter IV, 29 U.S.C.A. §§461-466), and election requirements (Subchapter V, 29 U.S.C.A. §§481-483); and, of significance to the present case, it imposes fiduciary duties upon union officials in relation to their unions (Subchapter VI, 29 U.S.C.A. §§501-504).

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[4] *Holdeman v. Sheldon* (S.D. N.Y., 1962) 204 F. Supp. 890, at 896.

The LMRDA provides varying procedures for enforcement of the substantive rights which it creates. The "Bill of Rights" (§411) is enforceable through civil suits in the federal district courts by individuals whose rights have been infringed (§412). Reporting, trusteeship and election requirements are enforceable by civil actions brought by the Secretary of Labor (§§440, 464, 482). The fiduciary obligations imposed by §501(a) on union officers are enforceable in civil suits by union members (§501(b)), provided that "the labor organization . . . refuse or fail to sue or . . . secure . . . appropriate relief within a reasonable time after being requested to do so. . . ." (§501(b)).

2. Exhaustion of union remedies is not a prerequisite to suit under §501.

Reasonably interpreted, the LMRDA does not require exhaustion of internal union remedies as a prerequisite to suit under Section 501. Section 501(b), authorizing civil actions by union members, does not on its face require exhaustion:

> When any officer, agent, shop steward, or representative of any labor organization is alleged to have violated the duties declared in subsection (a) of this section and the labor organization or its governing board or officers refuse or fail to sue or recover damages or secure an accounting or other appropriate relief within a reasonable time after being requested to do so by any member of the labor organization, such member may sue such officer, agent, shop steward, or representative in any district court of the United States or in any State court of competent jurisdiction to recover

> damages or secure an accounting or other appropriate relief for the benefit of the labor organization. No such proceeding shall be brought except upon leave of the court obtained upon verified application and for good cause shown, which application may be made ex parte. . . .

The express requirement of §501(b) that before suit is brought, a "request" first be made of the union and the union be afforded a reasonable time in which to sue, has been interpreted in the only appellate decision on the point, as a *substitute* for the pursuit of more complex internal remedies. *Holdeman v. Sheldon* (Cir. 2, 1962) 311 F.2d 2, *aff'ing* 204 F. Supp. 890.

As stated by the District Court in *Holdeman v. Sheldon* (S.D. N.Y., 1962) 204 F. Supp. 890, at 896:

> If anything, the fact that Congress made specific reference to exhaustion of internal remedies under §101(a)(4), 29 U.S.C.A. §411(a)(4), *and adopted a different procedure under §501(b),* both sections being enacted at the same time as part of a comprehensive revision of the labor law, leads to the conclusion that *the concept of first exhausting internal remedies was knowingly omitted.* (Emphasis added.)

The District Court opinion in *Holdeman* was described by the Court of Appeals as a "thorough and well-reasoned opinion," and was endorsed with the statement that "all of the questions raised on this appeal were fully and adequately answered in the opinion of the court below and we affirm for the reasons there stated." *Holdeman v. Sheldon* (2nd Cir., 1962) 311 F.2d 2, at 3.

The most recent decision on the point likewise holds that Section 501 does not require exhaustion. See *Persico v. Daley* (S.D. N.Y., 1965) 239 F. Supp. 629, 632.

A single District Court decision, *Penuelas v. Moreno* (S.D. Cal., 1961) 198 F. Supp. 441, has held, on the other hand, that Section 501(b) contains an unstated exhaustion requirement. *Penuelas* was flatly rejected in *Holdeman, supra,* 204 F. Supp. 890 at 896, with the statement that "This court sees no warrant for engrafting this requirement on §501(b)"; *Penuelas* was later characterized as "questionable" by the same court in which it had been decided, see *Delahery v. Marine Cooks and Stewards Union* (S.D. Cal., 1961) 199 F. Supp. 270, at 274; and it was generally disapproved in *Nelson v. Johnson* (D. Minn., 1963) 212 F. Supp. 233 at 257, *aff'd* (Cir. 8, 1963) 325 F. 2d 646.

As a matter of rational statutory construction, an exhaustion requirement should not be "implied" in §501(b). The explicit "request" requirement set forth in §501(b) cannot be reconciled with Congressional intent to "imply" a *further* requirement of exhaustion. The simple request specified in §501(b) would be superfluous if a member had already exhausted more formal internal remedies. Exhaustion of internal remedies necessarily entails numerous "requests" of a union, in the form of motions, petitions and the like, with responsive union decisions. The only reasonable interpretation of the request requirement in §501(b) is that placed upon it by *Holdeman;* that is, that it was intended as a *substitute* for exhaustion.

There is a plain reason why Congress did not require that internal union remedies be exhausted prior to bringing suit under Section 501: a breach of trust by a union officer is not curable internally. Internal remedies can no more cure such an injury than they can compensate the union for the negligent destruction of the union hall by fire. While internal remedies may determine questions of status, voting rights, and internal grievances generally, no internal action by the union can effectively secure money damages for a breach of trust by union officials. The only effective remedy in this setting is a judgment, and unions lack the power to render enforceable judgments.

The one material decision which a union *can* make in the context of a dispute under §501 is whether it will itself *control* proposed litigation regarding claimed abuses of trust; Section 501(b) thus requires that this decision—but only this decision—be made by the union before suit may be initiated by a union member.

3. Nature of the exhaustion requirement under Section 411(a)(4).

Section 411(a)(4) of the LMRDA has been interpreted as creating a federal exhaustion doctrine. This doctrine has been derived from the provision of Section 411(a)(4) which, while protecting the right of union members to bring suit against the union or its officers, provides "that any such member *may* be required to exhaust *reasonable* hearing procedures (but not to exceed a four-month lapse of time) within such

organization, before instituting legal or administrative proceedings against such organizations or any officer thereof . . ." (Emphasis added.) As discussed above, the courts have refused to "engraft" this exhaustion doctrine upon §501(b) of the LMRDA; it has, however, been uniformly imposed in civil suits under §412 of the Act, seeking to enforce the "Bill of Rights." Such cases are discussed below.

In the leading case interpreting the exhaustion provision of §411(a)(4), *Detroy v. American Guild of Variety Artists* (Cir. 2, 1961) 286 F. 2d 75 *cert. den.* 366 U.S. 929, 81 S.Ct. 1650, 6 L.Ed.2d 388, the court held that because the statute says exhaustion "may" be required, such exhaustion is *not* an absolute condition of suit: "The statute provides that any member of a labor organization 'may be required' to exhaust the internal union remedies, not that he 'must' or 'is required to' exhaust them." *Detroy, supra,* at 78.

Detroy further held that such exhaustion requirement is to be imposed, if at all, by the courts, not the labor organizations, and that Congress has left to the courts the problem of formulating both the criteria for determining when the requirement "may" be imposed and also the tests for determining what internal remedies are "reasonable" within the meaning of Section 411(a)(4). See *Detroy, supra,* at 78, et seq.

Detroy and the subsequent cases have held that the decision to impose an exhaustion requirement must be made in the light of all the facts of each case, including the nature of the claims asserted—that is, the

merits of the case—as well as the nature of the internal remedies claimed to have been available but not pursued. The specific circumstances which were found in *Detroy* to warrant direct access to the courts, without previous exhaustion, were that the facts on their face revealed a violation of §411(a)(5), that it was not clear either that the union rules really did afford a remedy or, if a remedy existed, that it had been called to the attention of the complaining member, and, finally, that the remedy suggested was probably inadequate.

Because imposition of the requirement is thus addressed to the broad discretion of the court, a number of courts have refused to pass on the question on motion, stating that it cannot be properly determined before trial. Thus, it has been held that "the exhaustion of internal remedies is a matter which should be alleged as an affirmative defense" and that exhaustion need not be pleaded by the plaintiff; see *Branch v. Vickers, Inc.* (E.D. Mich., 1962) 209 F. Supp. 518, 520. ". . . [S]ince Detroy definitely established that exhaustion of union remedies is not an absolute condition precedent to federal jurisdiction, there is no pleading requirement that a plaintiff allege such exhaustion in order to defeat a motion to dismiss." *Deluhery v. Marine Cooks and Stewards Union, AFL-CIO* (S.D. Cal., 1961) 199 F. Supp. 270, at 275.

The trend of the cases against resolving issues of exhaustion on motion was described in *Deluhery v. Marine Cooks and Stewards Union, AFL-CIO, supra,* at 275, as follows:

> . . . *Where a plaintiff does not plead exhaustion, factual questions are raised as to whether the plaintiff actually did exhaust internal remedies, whether reasonable remedies were available, whether in the particular case a plaintiff should be required to utilize such remedies, which questions cannot properly be determined on a motion to dismiss but must await trial* for their ultimate determination. Cases taking or implying this approach include Hughes v. Local No. 11 of Internat'l Ass'n of Bridge, etc., 287 F. 2d 810, 819 (3 Cir. 1961); Figueroa v. National Maritime Union of America, 198 F. Supp. 946 (D.C.S.D. N.Y. 1961); and Rekant v. Shochtay-Gasos Union, etc., 194 F. Supp. 187 (D.C.E.D. Pa. 1961). In the present case, *the court is loath to determine the vital questions raised either on the basis of the pleadings or on the basis of conflicting affidavits* and therefore adopts the approach of these recent cases, declining to determine the matter at this time, either on motion to dismiss or on motion for summary judgment. (Emphasis added.)

See also, *Thomas v. Penn Supply and Metal Corporation* (E.D. Penn., 1964) 35 F.R.D. 17, at 19.

In the instant case, the lower court apparently determined "the vital questions raised" before a complaint had even been filed. Even if Section 501 required exhaustion—which it does not—it would certainly have been error to rule on the exhaustion issue prior to the commencement of the action.

4. Exhaustion: the "internal remedies" purportedly available to appellants were both futile and unreasonable.

Even if plaintiffs were required in a §501 action to exhaust internal remedies, no *internal* remedy, however exhaustively pursued, could cure the breaches of trust which are the subject of this action. Recovery of the funds contributed to the Severance Plan lies outside the power of the union. In *Detroy,* exhaustion was not required for the reason, *inter alia,* that it was merely *unlikely* that union remedies would resolve the dispute: "If it is *probable* . . . that court proceedings will be instituted even after the remedies are exhausted, not even the policy calling for exhaustion in order to conserve judicial resources applies." (Emphasis added.) *Detroy, supra,* at 80. *A fortiori,* exhaustion should not be required where as here, it is *certain* that the union would be unable to remedy the complaint internally.

Moreover, the claimed "remedies" involved in this case were not even available to appellants. At the hearing below, the only internal remedies suggested by appellees were (1) Referendum (a District-wide vote), and (2) Code of Trial by Charges (C. 138-139). Such "remedies" were, on the face of the By-laws of the District and the Constitution of the National Marine Engineers' Beneficial Association, both unreasonable and futile.

(a) Referendum.

The function of a "referendum" vote is generally defined in Article I of the District By-Laws as "authorization for any union action." However, a referendum may *not* be secured by a member individually; it is *only* the *District Executive Committee* (comprised of appellees herein) which is authorized "to submit to a referendum vote among the membership any issue, policy or action."

> The *District Executive Committee shall have the authority,* wherever *it* may determine that it is in the best interest of the membership, *to submit to a referendum vote* among the membership any issue, policy or action. The vote thereon shall have the same binding effect as a vote by a majority of the membership. Any such referendum shall be conducted in accordance with the procedure outlined in these By-Laws for elections except that the time and duration of the vote and all other pertinent details shall be set by the District Executive Committee. (Emphasis added.)
>
> (By-Laws, Article VI, Section 5(1).)

While it may be true, as counsel for appellees represented to the lower court, that "any member can propose . . . that a referendum vote be taken" (1 R. 55:13-15), it is equally plain from the face of the by-laws that such a "proposal" can be summarily rejected by the District Executive Committee, which is "comprised of most of the [appellees] herein," and "dominated and controlled by [appellee] Ferron." (C. 115:8-14). Indeed, it was undisputed that appel-

lants had made a formal demand on appellees to take whatever action was necessary to recover the subject funds; and it was undisputed that the Committee has not called for a referendum. The "remedy" of referendum was exhausted.

(b) Code of Trial by Charges.

The other "internal remedy" suggested by appellees was a "Code of Trial by Charges" authorized by Article XII of the District By-Laws. Section 1 of Article XII provides that the National Constitution shall govern the filing of such charges. The National Constitution, however, provides, at Article VIII, that charges involving wrongdoing by district *officers,* while in office, may only be filed by a National officer, three members of the National Executive Committee "or by a 10% vote of the members in good standing of said District."

Thus the Code of Trial by Charges, like the Referendum, is *not* available to an individual member; it can be initiated against an offcer only by National executives or by 10% of the entire District membership; and its end product is at most internal discipline and not the return of the funds. In sum, the "internal remedies" proposed by appellees were not only futile, they were not even available. As stated in *Detroy:*

> When asserting what is clearly a violation of a federal statute, a union member should not be required to first seek out remedies which are dubious. (p. 80).

D. THE DOCTRINE OF THE LAW OF THE CASE IS INAPPLICABLE.

Appellees contended below that a ruling in the Local 97 action, denying a motion of the plaintiffs therein to amend their complaint to join District, became "the law of the case" (C. 99-101) as to the right of appellants to file the proposed complaint in this proceeding. No authority was cited to support this argument.

Appellees' contention respecting "law of the case" was plainly inapplicable; that doctrine applies only to final judgments:

> We think that it requires a final judgment to sustain the application of the rule of the law of the case just as it does for the kindred rule of res judicata.
>
> *United States v. United States Smelting, Refining & Mining Company* (1950) 339 U.S. 186, at 199, 94 L.Ed. 750, at 761, *rehearing den.* 339 U.S. 972, 94 L.Ed 1379.

See also, *Brown v. Brown* (D.C. Cir., 1941) 122 F. 2d 219, at 220.

The decision in the Local 97 action denying plaintiffs' motion for leave to amend was not a final judgment. *National Machinery Company v. Waterbury Farrel Foundry and Machine Company* (Cir. 2, 1961) 290 F. 2d 527; *Hancock Oil Co. v. Universal Oil Products Co.* (Cir. 9, 1941) 120 F. 2d 959, at 960, *cert. den.* 62 S.Ct. 127, 314 U.S. 666, 86 L.Ed. 533.

Moreover, the ruling in the Local 97 action was based upon the then failure of plaintiffs to request

the District to institute the action on its own behalf, as required by Section 501(b). (C. 128:30-129:15). The ruling in the Local 97 action did not, therefore, preclude the commencement of an independent action on behalf of District *after* a proper request had been made that the District take appropriate action. The necessary request was made before commencement of the present action. A dismissal based upon the plaintiff's failure to perform some necessary procedural act does not prevent the plaintiff from seeking the same relief after the act has been performed. *Bland v. Connolly* (Cir. D.C., 1961) 293 F. 2d 852, at 855.

E. RULE 23 OF THE FEDERAL RULES OF CIVIL PROCEDURE DID NOT BAR THE FILING OF APPELLANTS' COMPLAINT.

Finally, appellees contended in the lower court that appellants had not "set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort," as required by Rule 23(b) of the Federal Rules of Civil Procedure.

Rule 23(b) is obviously designed for derivative actions instituted by corporate shareholders: it is captioned *"Secondary Action by Shareholders"*, and it sets forth the prerequisites for "an action brought to enforce a secondary right on the part of one or more *shareholders.*" It requires, *inter alia,* that the plaintiff

was a *shareholder* at the time the transaction of which he complains occurred, and that the complaint set forth plaintiff's attempts to have the managing *directors* or *shareholders* take the action he seeks. Rule 23(b) plainly has no application to suits brought by union members under the express authority and meeting the specific procedural requirements of the LMRDA.

However, if Rule 23(b) were applicable to the pending case, appellants would nevertheless have satisfied its requirements. The verified complaint alleges that:

> Plaintiffs have requested the District, its Executive Committee, and Officers to take such action as might be necessary in order to recover for the District the above described payments to defendant Bank, but the District, Executive Committee, and Officers have refused so to do. A reasonable time for such action has now elapsed since the making of said requests. Accordingly, plaintiffs bring this suit for the benefit of the District and its Members.
>
> (C. 68:17-23).

Appellants further alleged that they are members of District and were members at all relevant times mentioned in the complaint:

> Plaintiffs Louis Horner, John L. Connolly, Victor Romero, James Riemers, and Hugh Bell are and at all times herein mentioned were members of The Pacific Coast District of National Marine Engineers' Beneficial Association.
>
> (C. 66:18-21).

Finally, it seems perfectly clear that Rule 23 could under no circumstances support the judgment of the lower court. Even if it applied, and if the complaint were defective in that regard, the defect would at most be a technical pleading matter curable by amendment.

CONCLUSION

Appellants submit that good and compelling cause exists for bringing this action. The evidence offered by appellants in the lower court would have been more than adequate to defeat either a motion to dismiss or a motion for summary judgment. Indeed, had the hearing below been a trial on the merits, appellants' evidence would have supported a judgment in their favor. Appellants' showing below was surely sufficient to entitle them to file a complaint.

Dated, Oakland, California,
October 7, 1965.

Respectfully submitted,
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Certificate of Counsel

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

John F. Wells,
Attorney for Appellants.